Credit Extension Subgroup Report

Federal Credit Policy Working Group

August 1991

REVIEW AND RECOMMENDATIONS FOR OMB BULLETIN 91-05 ON GUARANTEED LOAN POLICY

Prepared by the Credit Extension Subgroup
of the Federal Credit Policy Working Group

Presented on June 4, 1991
to the Federal Credit Policy Working Group

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Introduction

The Federal Credit Policy Subgroup on Credit Extension was established to examine Federal guaranteed loan programs, suggest improvements, and recommend enhancements to OMB Bulletin 91-05 on guaranteed loan policy. The Subgroup, chaired by Jonathan Kislak, Deputy Under Secretary, U.S. Department of Agriculture, consisted of credit management officials and program managers from the Small Business Administration, Farmers Home Administration, and the Departments of Veterans Affairs, Housing and Urban Development, and Education.

The Subgroup believes that fundamental changes need to be made in government/lender relationships. Emphasis of agencies should be shifted to better management of lenders, not better management of individual loans. Agencies should concentrate efforts on the management of overall program risk consistent with optimum program delivery.

The oversight provided by credit agencies to lenders must be strengthened. Generally, an agency's program management can be most effectively performed by managing lenders, rather than trying to manage each individual loan. This can be accomplished through the lender agreements, lender reviews, a recertification process, and lender monitoring as sketched out in the Bulletin. Lenders should be certified for various functions and at various levels which reflect their competence and expertise. Regularly scheduled recertification reviews should be put into place, involving detailed reviews of lender operations and financial statements. Lender originations and portfolio data should be reviewed regularly, on an automated basis, to monitor trends and identify emerging problem situations. Agencies must have the authority to reduce lenders' program authority quickly in response to emerging problems. The current debarment and suspension process is often too cumbersome to protect the Government's interests.

Methodology

Guaranteed loan program subject matter was divided into five categories: credit reform and lender risk sharing; the lender relationship; program issues including credit scoring and program standards; inventory and asset disposition; and internal management reporting. Agencies submitted background papers describing their operations concerning each of these topics. Various speakers from other agencies and private industry were invited to present additional information on selected topics.

The Subgroup was divided into four committees, and each committee was assigned portions of OMB Bulletin 91-05 to review: lender relationships, risk sharing, underwriting standards, and inventory management and asset disposition. Based on the committee research, presentations by outside speakers, and insight of the program managers, several principal recommendations emerged.

Principal Recommendations

1. Extend the emphasis of Government agencies toward better management of lenders instead of the current concentration on better management of individual loans. This approach is consistent with the private sector and will help the Government contain its exposure. Agencies' efforts toward this end can be assisted by implementing the following three initiatives:

   a. <u>Create a common data collection facility to handle all data requirements for lender monitoring</u>.

      An effective data collection effort is an absolute prerequisite for the success of the lender monitoring process for any guaranteed program.

Currently each agency is responsible for collection, storing, and reviewing data independently. The quality of these efforts varies widely. Each agency has its own computer development and maintenance expense, and its own reporting format. Lenders participating in more than one program face a variety of reporting requirements and formats.

The Subgroup recommends creating common lender monitoring database. Lenders would submit regular reports on all Federal programs to only one location and in one format, which should increase reporting compliance, enhance the quality of the data, and reduce the paperwork burden of the private sector. Agencies would access the central database to review lenders in their program. All agencies could take advantage of the economies of scale of this central facility, and redundant work performed across agencies might be eliminated.

The database facility would be constructed to automatically prompt notification of emerging deteriorating situations for agency actions. The common data collection would not replace the agency responsibility to use the information available to monitor lenders' activity. It would be solely the agency's responsibility to deal with lenders. The data collection responsibility would function as a passive "service bureau" for the program agencies.

Creation of the common facility would include consideration of the:

- o feasibility of a common facility across program lines.

- costs and benefits of a common facility.
- reduction of the paperwork burden on the private sector.
- availability of better information for better program supervision by individual agencies.
- possibility of building upon an existing agency or private sector computer structure.

b. Employ lender agreements that contain standardized core requirements, but are program specific and allow agencies flexibility to address specific agency concerns. Agreements would be standardized within each program to outline the obligation of the lender and servicer. Program requirements and concerns are too heterogeneous to create one standard government-wide agreement. However, the formats should be uniform and many of the provisions should be similar or identical. Unique agency concerns could be addressed in appendices.

c. Recertify lender/servicer participation on a regular basis based on measurable performance and capability standards. Continued program participation should not be a right or an entitlement of lenders after they have originally been certified. Agencies must have the authority to deny recertification, and even suspend a lender's participation, if deteriorating trends emerge. If necessary, legislation should be pursued to ensure that agencies have the flexibility to suspend and deny recertification to participating lenders.

2. Study the feasibility of one centralized location responsible for the maintenance and disposition of all single family housing property acquired by all lending agencies. There is now no coordinated government-wide plan for disposing of acquired properties. Agencies develop individual plans, not a coordinated cross-agency strategy. Agencies may be in direct competition in certain areas, which reduces returns to the Government unnecessarily and depresses prices for non-governmental sellers. The study should determine whether central coordination of these efforts will reduce Government costs and possibly increase revenues.

Other Concerns

The Subgroup has serious concerns about two other issues essential to guaranteed loan management: risk sharing and credit scoring.

<u>Risk Sharing</u> - Increasing the proportion of risk borne by lenders may increase credit quality of individual loans. However, agencies face various conflicting goals, including promoting programs to the public and serving their clientele. Raising lenders' risks will diminish the attractiveness of the programs to lenders and reduce their interest in participating. Further, most existing risk sharing formulas are long-lived and based on legislation. Attempts to make major changes might be counterproductive and detrimental. The Subgroup is concerned that abrupt changes in risk sharing between lenders and agencies in successful existing programs will disrupt delivery systems and reduce service to clientele. The Subgroup believes that raising lenders' risks is not the only way to increase the private sector's attention to creditworthiness. The Subgroup recommends studies of the effect of increasing risk on the profit/risk relationship and of alternative means of risk sharing.

Credit Scoring - No evidence was found that any private sector company relied solely on credit scoring as an underwriting method. Frequently, the principal determinant of loan failure is a catastrophic change in the borrower's circumstances - death, unemployment or divorce - which cannot be measured by a scoring system. The Subgroup is concerned that the Bulletin places too much reliance on credit scoring models as a tool to allocate credit. Credit scoring models may be useful for lender reviews, lender evaluations, and to extend credit. However, credit scoring should never be used to deny credit - the decision to deny credit should be based on an individual human judgmental decision, not on a scoring formula.

Purpose

In its charter, the Federal Credit Policy Subgroup on Credit Extension was "commissioned to recommend credit underwriting procedures, standards, and controls for guaranteed loans secured by real estate....The subgroup might consider options such as pre-screening for prior defaults, credit analysis, credit scoring models, documentation, and various recommendations of the financial information subgroup." In general, the participants of the Subgroup were to gain an understanding of the differences among the programs represented in the group, to exchange ideas for general improvements of guaranteed loan programs government-wide, and to have the widest possible input into the codifying of OMB Bulletin 91-05 into a government-wide circular.

In addition to the Subgroup's charter, Tom Stack of the Office of Management and Budget asked the Subgroup to review and provide recommendations for changes to the policy guidance provided in the present OMB Bulletin 91-05. OMB plans to enhance OMB Circular A-129 to include the guaranteed policy and the Financial Management Service will be developing a Treasury Financial Manual to provide the details on guaranteed loan management. Recommendations from the Subgroup will be used by OMB and Treasury in completing these two efforts.

Composition

The Subgroup was chaired by Jonathan Kislak, Deputy Under Secretary, U.S. Department of Agriculture. Membership consisted of representatives from the Small Business Administration (SBA), Farmers Home Administration (FmHA), Department of Veterans Affairs (VA), Department of Housing and Urban Development (HUD), and Department of Education (ED).

Invitations to participate specifically requested that program managers be appointed to the Subgroup to assure the program staff's involvement and input in developing recommendations. In addition, representation included the Office of Management and Budget and Treasury's Financial Management Service.

Agenda

The guaranteed loan program subject matter was broken down into the following five categories to parallel the circulation draft of OMB Bulletin 91-05:

1. Credit reform and lender risk sharing
2. Lender relationships
3. Program issues including such topics as credit scoring and program standards
4. Inventory management and asset disposition
5. Internal management reporting

The five program agencies (ED, FmHA, HUD, SBA, and VA) were asked to provide background papers discussing each agency's operations concerning the above topics. To secure widespread participation, a Subgroup member or group of members was slated to lead the discussion on each particular topic.

Speakers

Various speakers were invited to the meetings to present additional information on the above topics.

- October 23, 1990 -- Justine Rodriguez from OMB discussed credit reform. She stated that credit reform attempts to create a consistent and comparable basis of measuring the costs of credit transactions so that proper budgetary decisions can be made.

Specifically, all subsidy costs and cash flows arising from direct loan obligations and guaranteed loan commitments made will be recorded in separate program accounts for each agency. She also stated that credit reform will require all agencies to acquire a significant amount of data and record all supplemental events associated with a specific transaction.

- November 1, 1990 -- Thomas Hook from Fannie Mae spoke about its operations. Mr. Hook focused on four main points:

  1. Fannie Mae manages the lenders, not the loans.

  2. The contract between Fannie Mae and its lenders plays an important part in defining the lender relationship and facilitates its efforts in managing the risks in their loan portfolio. Fannie Mae sets the policies and standards, delegates the underwriting and servicing decisions to the lenders, and holds the lenders responsible through the use of a comprehensive and detailed agreement called the Mortgage Selling and Servicing Contract.

  3. Fannie Mae uses a team concept in its marketing and monitoring endeavors. These teams perform marketing, quality control and lender administration that help manage and guide the lenders through the complete loan life cycle. These teams, based in regional offices, are also responsible for the risk management of their assigned portfolio performing a variety of risk analyses such as examining market, product, and institutional risk.

4. Fannie Mae conducts a comprehensive evaluation of the participating lenders--examining each lender for sufficient financial stability, for appropriate underwriting standards, for adequate operations and systems, staff knowledge and experience, and fidelity insurance. Also, Fannie Mae maintains a sophisticated computer system which can capture, track and, manipulate portfolio information down to a very detailed level. It can provide managers with key underwriting, delinquency, and servicing statistics, which enables them to construct models for their use in ascertaining lender and portfolio performance. Furthermore, Fannie Mae conducts various reviews (ranging from extensive 2-3 week on-site audits to random and selected post-purchase screenings), examines the lender's operational systems and procedures, and evaluates the lending and support staffs for experience, knowledge and stability.

o November 14, 1990 -- Mike Hellenbrand from Bear, Stearns and Company conducted a presentation on risk sharing. The underlying theme of his presentation was that the private sector conducts in-depth risk analysis and associates a price with the degree of risk that is assumed. Also, the private sector attempts to insure that the originators and servicers maintain an interest in the loans through a risk sharing arrangement. The private sector often shares risk in pools of loans rather than in each individual loan.

o January 23, 1991 -- Jim Wagner, PMI Mortgage Insurance Company (a Sears subsidiary) made a presentation on loan making, underwriting, and program issues such as credit scoring and program standards. He discussed PMI's primary mortgage insurance and credit enhancement products. He also explained that PMI uses several tools for evaluating credit.

These tools include the Automated Underwriting Risk Analysis (AURA) and the Economic/Real Estate Trends Report. AURA is a computerized risk evaluation system designed to serve as a tool for underwriters and managers in the measurement of risk quality. It tracks loan quality through reports and special audit capabilities. AURA also provides assistance in evaluating lender performance. PMI believes the most significant indicator of a borrower's probable success is their previous credit. The Economic/Real Estate Trends Report is a tracking and monitoring tool that forecasts economic and real estate trends on a local market basis. It analyzes the critical components of local supply and demand looking at the unemployment rate, annual employment change, annual housing starts, and resale housing inventory.

o February 27, 1991 -- Paul Stanley, GAO Regional Office in Seattle, discussed a new GAO study focusing on management and disposition of federally-owned, single family, foreclosed property. At the same meeting Stuart McFarland, General Electric Capital Asset Management Corporation discussed inventory management and asset disposition standards. He stated that the principles of asset management include security and control over the management and disposition of assets in the inventory to protect against fraud, abuse, and mismanagement. He found that bankers, various Federal agencies and his clientele all had houses in the same subdivisions and that return on sales was increased through cooperation.

Committees

The Subgroup was divided into committees and each committee was assigned a section of OMB Bulletin 91-05. The committees and their assignments are listed as follows:

Committee	Chair	Section Assignment in 91-05
Lender Relationships	Alan Schneider, VA	II. A. (all) II. B. 1. (a), (b), (c), (e) II. B. 4. II. C. (all)
Inventory Management and Asset Disposition	John Coonts, HUD	II. E. (all)
Risk Sharing	Walter Intlekofer, SBA	II. B. 1. (d)
Underwriting Standards	Jack Hertzler, FmHA	II. B. 2. and 3.

General Conclusions

The Subgroup believes that fundamental changes need to be made in government/lender relationships. Emphasis of agencies should be shifted toward better management of lenders, not better management of individual loans. Agencies should concentrate efforts on the management of overall program risk consistent with optimum program delivery.

The oversight provided by credit agencies to lenders must be strengthened. Generally, an agency's program management can be most effectively performed by managing lenders, rather than trying to manage each individual loan. This can be accomplished through the lender agreements, lender reviews, a recertification process, and lender monitoring as sketched out in the Bulletin. Lenders should be certified for various functions and at various levels which reflect their competence and expertise. Regularly scheduled recertification reviews should be put into place, involving detailed reviews of lender operations and financial statements. Lender originations and portfolio data should be reviewed monthly, on an automated basis, to monitor trends and identify emerging problem situations. Agencies must have the authority to reduce lenders' program authority quickly in response to emerging problems. The current debarment and suspension process is often too cumbersome to protect the Government's interests.

Following is a detailed discussion of the Committees' efforts, and the recommendations of the Subgroup. Appendix I is a summary of specific comments and recommendations related to the various sections of OMB Bulletin 91-05.

In General

The existing Bulletin asks too much of the term "lender." There is a wide variety of activities performed by lenders, from loan origination only, to origination and servicing, to servicing only, to passive ownership only. In much of the Bulletin, "lender" is used to refer to originator, but in some cases, "lender" encompasses originator and servicer. Servicers are addressed explicitly in several sections, but not mentioned in other, significant sections. This ambiguity should be eliminated by referring directly to the specific functions of lenders that are of concern and addressed in each section. Specifically, each agency should address, separately, eligibility of entities to originate loans, and the eligibility of entities to service loans. We recommend no government-wide restrictions for ownership-only entities. For certification and recertification, criteria should be established for originators, and different criteria established for servicers. Increased attention should be given to those institutions that primarily service loans, or only service and do no originations.

Performance Standards

Originators and servicers should submit data on a regular basis on all loan activity to allow agencies to monitor performance. The Subgroup recommends creation of a government-wide system to receive and maintain regularly-submitted data from all originators and servicers, for all credit programs. Agencies would access this central database at whatever frequencies are appropriate for their lender monitoring. We propose lenders submit data directly to a common facility eliminating lenders' responsibilities to report the same information to multiple agencies on different formats. This data system will enhance reporting compliance as lenders will be more reluctant to violate a government-wide mandate than they would be to violate an agency requirement.

The various reports that agencies currently should require contain basically the same material in different formats. The costs to develop a common system or to adapt a currently existing one will be recouped by allowing information to be utilized more effectively. A system with one format would reduce the paperwork burden on the private sector. One common data management system will minimize costs to the Government as economies of scale would accrue to all the users and minimize costs to the private sector.

Data reporting must be sufficient to satisfy the various data needs of lender monitoring as well as reporting requirements of Treasury and OMB. That is, the reporting must be sufficient to complete the Schedule 8 report, perform loan classifications, validate "risk group" needs for credit reform and provide lender management data for agency action. Centralizing this activity will minimize costs, increase compliance, and minimize private sector criticism of "excess reporting burdens."

Standard Lender Agreements

To the degree possible, agencies should have standard agreements consistent by program type. Standard lender agreements should be created for each program. Common core elements should be identified to be included in the standard lender agreements. Formats should be uniform and many of the provisions across programs should be similar or identical. The agreements could be designed such that agencies tailor standard clauses to their individual programs and provide for other agency specific concerns in appendices. Lender agreements for each program should include provisions for: recertification, performance standards, evaluation, and penalties. The agreements should differentiate between originator requirements and servicer requirements. The agreements should also differentiate between various levels of rights and responsibilities of originators. These could be incorporated as separate sections in one document, or separate agreements could be developed.

For certified originators and servicers, the agreements would be executed at the time of certification and recertification. For non-certified originators, an agreement would be executed with each loan.

Certification

The model implicit in the Bulletin allows for only one category of originators - that is, "certified originators." However, several agencies have successfully stratified lenders and created a spectrum of categories of participating originators. The Subgroup recommends allowing agencies to create various categories of participating lenders. At one end of the spectrum would be very infrequent participating originators, categorized as "non-certified," who would submit the necessary underwriting and financial institution data with each loan application. These originators could participate in the program but would in effect undergo a certification review with each loan application. At the other end of the spectrum would be large, frequent program participants, who were financially sound and had extensive program experience. Agencies may extend to originators at this end of the spectrum the authority to take independent action without prior agency review, such as SBA's "preferred " lenders and lenders who have FHA and/or VA delegated underwriting authority. Agencies should have the flexibility to establish the number and nature of the categories, basing their decisions on the program type, volume of loans, delinquency, experience of staff, previous history in the program, etc. Agencies could, likewise, create multiple categories for servicers where program allows function to be split.

All originators and servicers should be subject to decertification based on any findings that the servicer is engaging in practices which are detrimental to the interest of the agency or program beneficiaries.

The certification process involves the determination of the category in which to allow a lender to participate. The recertification process is a re-evaluation of the lender's right to continue to participate, and in which category to participate. Recertification would take place annually or at various intervals up to five years depending on loan volume and performance. Recertification at any participation level is not a "right" of a lender after the lender has once been certified. Agencies must have the authority to decertify, change the level of certification, or suspend a lender's program participation whenever it is in the best interest of the Government. The recertification represents a reapplication to participate, and involves a review of all relevant lender data and the lender's performance.

Agencies must have the freedom to take decertification or debarment action at any point in a lender's review cycle. Unscheduled on-site reviews could be held and sanctions levied whenever it is found necessary to protect the Government's interest.

It is vital that impediments to an agency's right to refuse to recertify a lender, whether in law or executive order, be removed. Recertification must be a prerogative of the Government unencumbered by a lender's "entitlement" based solely on past program participation. In fact, recertification should be similar to the initial certification process in that there should be no obligation on the agency to grant it.

> NOTE: State or private non-profit guarantee agencies serve as intermediaries between the Department of Education and participating lenders under the current structure of the Guaranteed Student Loan program, Education provides reinsurance coverage. Therefore, Education does not deal with the issues that resulted in recommendations under Lender Relationships concerning standard lender agreements and categories or certification/recertification of lenders and servicers.

Certification Fees

Agencies should charge fees sufficient to cover the cost of initial certification and the cost of recertification. The Subgroup recommends agencies have the right to waive the fee in the case of small infrequent program participants who participate on a "non-certified" basis.

Lender Reviews

Two levels of lender reviews are recommended. Regular reviews of data reported to the automated database would provide the basis for continuous lender monitoring. In fact, the database system should automatically highlight deteriorating situations for official attention.

Less frequently, detailed on-site reviews should be held. Prior to the visits, statistical samples of loans should be selected for in-depth review. The on-site reviews would cover process and documentation, along with investigating any irregularities revealed by the automated database reviews. These detailed reviews would be made in conjunction with recertification and whenever else appropriate.

Lender Review Checklist

Agencies should develop guidelines on the minimum requirements to be included in agency lender review checklists. While there will be many common elements, these checklists should be developed by the agencies, to be agency and program specific.

Single/Coordinated Lender Reviews

The Subgroup questions the ability to conduct effective government-wide lender reviews. Given the variety of program requirements and concerns, cross-agency reviews are probably not feasible. The Subgroup suggests consideration of a pilot study to determine the success of coordinated lender reviews, and suggests the pilot concern only the housing industry. The Subgroup believes that if coordinated government-wide reviews are conducted, they should be staffed with representatives from each of the programs in which the lender is involved.

Annual financial reviews of lenders and servicers might be centralized with results shared among effected agencies.

Lender Review Boards

Lender review boards should not be required, particularly as described in the Bulletin. The intent of the lender review board can be met by maintaining the authority to sanction at a high level within each agency. Agencies would have a difficult time obtaining the participation of managers at the levels specified by the Bulletin.

Lender Watchlist

The Subgroup disagreed about the establishment of a government-wide watchlist. A watchlist is difficult to compile and impossible to keep confidential. Even if possible, the efficacy of such a list is subject to question. It could severely damage the reputations of those institutions who might appear on it. The Subgroup recommends that this section of the Bulletin be omitted.

Penalties

Provisions need to be made to allow agencies to remove bad lenders more quickly, and action is needed to ease debarment procedures. Treasury should create and sponsor this initiative government-wide. Financial and other penalties short of debarment need to be included for lenders failing to meet program requirements. Lender decertification or reclassification should be a form of penalty available to the Government and agencies should determine when decertification is warranted.

Major Recommendations

1. A common lender monitoring database should be created. Lenders would report regularly into the database.

2. Lenders' reporting requirements should be sufficient to satisfy "Schedule 8" reporting, loan classifications, "risk group" requirements for credit reform, and provide lender management data for agency action.

3. Standardized lender agreements for each program should be created. These agreements should include uniform core requirements. Agreements would be required for all program participants, regardless of category.

4. Each agency should establish categories of originators and servicers. The requirements for certification and review would vary by category. Costs of certification would be borne by lenders.

5. Certification is not permanent. Agencies would periodically recertify lenders and servicers based on experience and program performance. Agencies must have the legislative and regulatory right to deny recertification or to reclassify the level of certification in a process less cumbersome than the current debarment process. The recertification process should not be an automatic entitlement of the lender.

6. Obtain a Department of Justice review of the right of agencies to refuse to recertify lenders. Legislation should be obtained as necessary to enable agencies to use sanctions including refusal to recertify as necessary. Government-wide debarment regulations now have no statutory basis. It is recommended that the statutes of all Government agencies be amended to include government-wide debarment authority on a basis consistent with the non-automatic nature of recertification.

7. A "non-certified" originator category should be established for occasional program participants. The certification fee could be waived. The lender would be required to provide a minimum level of data with each loan application.

8. Agencies' lender reviews will be of two forms. First, frequent routine monitoring of data maintained in a government-wide database. Second, detailed on-site reviews of loan files, processes, and documentation. Findings from reviews should be a vital part of the recertification process.

9. Develop guidelines on minimum regulations to be included in agency lender review checklists.

10. Section 525 of the Bankruptcy Code may cause problems by allowing financially unsound institutions to continue participating in a program while they are under bankruptcy protection. The Section states that "...a governmental unit may not deny, revoke, suspend, or refuse to renew a license, permit, charter, franchise, or other similar grant...against a person that is or has been a debtor under this title..." The term "person" includes corporation. It is unclear whether this Section covers recertification of lenders for continued participation in a guaranteed program, but the legislative history indicated the intent was to provide wide protection to firms and individuals under bankruptcy. Legislation should be changed to clarify agencies' ability to take action against firms in bankruptcy when necessary to protect the interests of the Government.

11. The requirement for a high level lender review board should be abolished. The benefits of this arrangement can be obtained by allowing agency heads to administer sanctions against lenders.

12. A government-wide watchlist should not be established.

13. "Supervised lenders" (banks and savings and loan institutions) may make Veterans Affairs (VA) loans without VA reviewing the underwriting. It is recommended that the law be changed to require all VA participating lenders to meet VA lender qualification standards.

Inventory Management and Asset Disposition Standards

The Subgroup recommends a study of the feasibility of having one central asset management and disposition facility for Government inventory property. The study should explore the effect of agencies marketing their properties independently, without coordination, and often in competition with each other on both the Government's and on surrounding property owners values.

Major Recommendation

1. A comprehensive study of the feasibility of consolidating the management and disposition of Federal single family housing property into one agency specifically created and authorized to perform such functions should be undertaken by a qualified non-governmental entity. The study should also evaluate the feasibility of designating an existing agency to handle sales. At least one employee from FmHA, VA, HUD, and the Resolution Trust Corporation (RTC) knowledgeable in management and disposition matters should be assigned as permanent members of the study team.

Risk Sharing

Striving to increase risk sharing to an 80%-20% ratio is only one method to ensure private sector attention to creditworthiness. This is not the only way to achieve this goal. Further, creditworthiness is not the only public goal agencies strive for. Other goals are to serve their clientele, to promote the programs, and to provide the programs to the public. The Subgroup is concerned that abrupt changes to existing, successful programs may do extensive harm. Participation by originators may significantly decline, thereby reducing access to the program by the public. Secondary markets would be disrupted. Changes in risk sharing should not be abrupt and should only be undertaken after extensive study of the implications of any changes. Other methods should be explored to increase lenders' attention to creditworthiness.

The principal determinant of lender participation in a guaranteed program is lender profitability. Not enough is known about the profitability of participants, and therefore, about the implications of changes in profitability on lenders' participation. The Subgroup recommends a study by an outside contractor on the profitability of various programs and the relationship to lenders' risks. This study would be performed by loan type, and would concentrate on developing information on risk/reward relationships. Since the mortgage industry is the most highly structured, it should be studied first.

The Subgroup recommends a second study be performed, on alternative ways to share risk and the implications on lender activities. Examples of risk sharing alternatives include requiring lenders to assume the first losses, up to a predetermined amount; increasing lender risk in exchange for increased lender autonomy in decision-making; and placing guarantees on pools of loans rather than specific loans. Altering the method of risk sharing might provide a way to reduce the Government's risk while leaving lender participation unaffected or even increased.

This study should include the implications on the secondary markets of changing risk sharing procedures.

Major Recommendations

1. Commission a study by an outside source of the profitability of participating lenders, focusing on risk/reward relationships.

2. Commission a second study on alternative ways to share risks, and the implications on lender participation, client service, and the secondary market.

Credit Scoring

The Subgroup is concerned about the importance placed on credit scoring models. No evidence was found that any private sector company relied solely on credit scoring as an underwriting method. For example, in the housing industry it is very difficult to forecast success or failure for individual applicants. The principal determinant of failure is a catastrophic change in the borrower's circumstances - death, unemployment, or divorce. These are not determinants that can be captured in empirical credit scoring formulas.

Each agency should have the discretion to determine whether or not credit scoring models are appropriate for its programs. Before models are placed into use, extensive validation testing should be performed to ensure that the models are performing as desired. When used, the models should be used only to extend credit, not to deny credit. The decision to deny credit should be made based on a human decision, not made automatically, based on a scoring formula.

Major Recommendations

1. Allow each agency the discretion to implement credit screening models.

2. Use the results of credit scoring models only as a basis to review lender performance or extend credit, not as a basis to deny credit.

APPENDICES

A. Eligibility, Certification, Recertification and Decertification of Lenders, Non-Federal Guarantors, and Servicers.

1. Eligibility

- o Recommend no change to the current requirements.

2. Lender Certification

- o Separate into Originator and Servicer Certification to distinguish between originators and servicers.

- o Allow for multiple categories of lenders based on volume of loans, program type, risk sharing formulae, quality of lending as measured by delinquency and other performance criteria, financial strength, experience of staff, previous history in program, etc. Grant originators varying degrees of authority to take independent action consistent with their level of certification. The model in the Bulletin allows only one category of originator (that is "certified").

- o Agencies shall determine categories appropriate to their programs.

- o Allow originators making a small number of loans to participate in the program on a "non-certified" basis and to be reviewed on a loan-by-loan basis. They would provide minimum data required with each loan.

- o Establish government-wide minimum core requirements for certification such as a bank call report, audited financial statements or equivalent, performance on other loans, and resume of loan officers responsible for loan servicing.

- o Review servicers separately as needed. Each agency to create a checklist.

3. Lender Recertification

- o Recertification should review whether a lender can retain current category status or should be moved to a new category.

- o Recertify all lenders after the first year.

- o Require annual recertification for significant lenders, other lenders at least every five years. Each agency to establish criteria for timing of recertification.

- o Base frequency of recertification on the Government's risk, size of portfolio, amount of origination, and performance of loans.

- o Include financial data and on-site review of a statistical sample of loans on lenders originating a large number or dollar amount of loans.

- o Recertify small volume lenders every 2-5 years, depending on government risk (activity in guaranteed programs, age of loans, delinquency).

- o Require that significant changes in a lender's operations be reported to the agency immediately.

4. Certification Fees

   - o Cover costs with fees for certification and recertification.
   - o Fees may be waived for non-certified lenders.

5. Lender Decertification

   - o Move this section under Lender Reviews-Penalties.

6. Loan Servicers

   - o Combine this section with Originator and Servicer Certification.

B. Standard Lender Agreements

- o Agreement should be agency and/or program specific with certain government-wide requirements incorporated.
- o Use separate criteria for originators and servicers in the agreements.
- o Sign agreement at certification and recertification or on a loan-by-loan basis.

- Establish requirements to reflect practices in the private sector where appropriate and particularly, recognize differences among commercial loans, mortgages, and unsecured personal loans.

1. General Participation Requirements

Risk-Sharing

- Do not require a 20-percent originator's share of the cost of defaulted loans. An abrupt change in the risk sharing percentage of existing, successful programs might disrupt the secondary markets of the affected programs and cause unintended harm to the programs and the citizens they were intended to assist.

2. Applicant Screening

- Provide that underwriting procedures meet agency guidelines in cases where the agency retains approval authority.

- Include tax lien searches, UCC filings, audited financial statements, production capability, market research, and environmental evaluations when screening commercial enterprises.

Credit Reports

- Establish a systematic review of credit reports.

Credit Risk Analysis

- o Use credit scoring only for lender monitoring tool and to extend loans. Loans should be rejected based on a human decision, not automatically rejected based on scoring. Give agencies discretion as to whether a credit scoring model is appropriate.

3. Collateral Requirements

- o Establish minimum collateral requirements for each agency's guaranteed programs consistent with legislative and program requirements

Appraisal Policy

- o Require lenders to use certified/licensed appraisers, as specified by FIRREA.

Loan-to-Value Ratios

- o Ensure the level of borrower risk is consistent with program intent.

4. Performance Standards

- o Create a common lender monitoring database with regular data from originators/servicers for all credit programs.

- o Require originators/servicers to submit data directly to this common data system.

- o Each agency to review originators/servicers regularly by program using the database, taking note of any deteriorating trends.

- o Collect sufficient data to complete Schedule 8, meet loan classification requirements, validate "risk group" needs for credit reform, and monitor lender performance.

Performance Rates

- o Highlight lenders, programs and/or regions with deteriorating trends.

- o Select lenders for special attention and intensive reviews.

C. Lender Reviews

- o Agencies' lender reviews will be of two forms. First, frequent routine monitoring of data maintained in the common database. Second, detailed on-site reviews of loan files, processes, and documentation. Findings from reviews should be a vital part of the recertification process.

- o Include off-site review of statistical data on portfolio and financial data on lender.

- o Include on-site review to look at loan origination and servicing files and activities for most lenders.

- o Review frequency should be based on categories of lenders, and the Government's risk.

- Conduct intensive recertification reviews, at a minimum, every 5 years for the smallest lenders based on program participation with no delinquencies and an established history of participation in the program, more often for larger lenders or for lenders with more problems.

1. Lender Review Checklist

   - Develop a checklist for each level of review.
   - Use government-wide guidelines or minimum requirements.
   - Develop checklist by agency and ensure it is program specific.

2. Single/Coordinated Lender Reviews

   - Government-wide coordinated reviews are not recommended.
   - If conducted, staff a government-wide review with a member from each program in which the lender is involved.

3. Lender Review Boards

   - Do not require lender review boards.
   - Meet the intent of Lender Review Board by keeping sanction authority at a high level within an agency.

4. Lender Watchlist

   - Delete this section from the Bulletin.

5. Penalties

   - Make consistent policies.

   - Remove bad lenders more quickly and ease current debarment procedures through legislation change.

   - Establish penalties for lenders failing to report as required.

   - Decertify originators/servicers as a form of penalty. Agencies would need to determine when decertification was to be applied.

D. Agency Portfolio Management

1. Early Warning Indicators

2. Loan Classification and Portfolio Valuation

   - The proposed common data management system should capture sufficient data to allow for automated loan classification which will be reviewed by the agency.

3. Annual Audited Financial Statements

E. Inventory Management and Asset Disposition Standards

1. Inventory Management System

- For the short term, recommend no change to the current requirements.

- Study the feasibility of establishing a centralized management and disposition facility for all inventory property (including property acquired under direct loan programs).

2. Asset Disposition Standards

- Allow agencies to require an appraisal at the time the lender notifies the agency of its intent to proceed with the liquidation of collateral or at the time the agency acquires the property.

United States Department of Agriculture | Office of the Secretary | Office of Finance and Management | Washington D C 20250

JUL 16 1991

Mr. Tom Stack
Chief, Credit and
Cash Management Branch
Office of Management and Budget
Washington, D.C. 20503

Dear Mr. Stack:

Reference is made to your July 3, 1991, memorandum regarding the SubGroup on Credit Extension Report. You requested that the Department provide comments on the Credit Extension Report and review the membership list of the Federal Credit Policy Working Group.

The following are the Department of Agriculture's comments on the Credit Extension Report:

- The last sentence of paragraph 2, "General Conclusions," on page 8, reads "The current debarment and suspension process is often too cumbersome to protect the government's interests." There is no discussion supporting this conclusion. The subgroup should provide support for this position.

- The subgroup recommends that the "Lender Watchlist" be omitted from OMB Bulletin No. 91-05. The "Lender Watchlist" is intended to include lenders that do not meet agency standards, or do not correct deficiencies identified through lender reviews in a reasonable period of time. If the "Lender Watchlist" is deleted from the bulletin, consideration should be given to some form of information sharing to protect the government's interest. The proposed "common lender monitoring database" could provide information for this purpose.

Sincerely,

Larry Wilson

LARRY WILSON
Director

"An Equal Opportunity Employer"

United States Department of Agriculture | Farmers Home Administration | Washington D C 20250

JUL 2 4 1991

Mr. Thomas Stack
Chief, Credit and Cash
Management Branch
Office of Management and Budget
Washington, D.C. 20503

Dear Mr. Stack:

The Farmers Home Administration (FmHA) was pleased to have the opportunity to review the report from the Sub-Group on Credit Extension of the Federal Credit Policy Working Group.

FmHA would like to offer the following comments.

o Recertification and Lender Reviews - FmHA does not now have the staff with the appropriate expertise to perform the extensive reviews of lender financial data described in the report. Existing bank regulators are in the best position to handle this responsibility. However, it is unknown whether this dimension could be added to regulators' existing responsibilities.

o Centralized Inventory Property Management - There are Agency-specific requirements for inventory property management (i.e. retention and disposition requirements). The proposed study of centralized inventory management must take into account agencies' diverse statutory mandates. We also suggest the study consider whether it would be cost-effective to include rural properties in the central unit or if restricting it to urban properties would be most effective.

o Centralized Database - It is unclear who is responsible for monitoring lender reporting compliance. It would be most efficient for the central data facility to identify and pursue lenders not meeting their reporting requirements.

o Promoting Guaranteed Programs - The primary complaint I hear in discussions with guaranteed lenders, and their industry organizations, is about excessive paperwork burdens placed on them in making and servicing guaranteed loans. Requirements for fees, reporting, etc., need to be considered with caution so as to not limit lender's interest in guaranteed programs.

Sincerely,

LA VERNE AUSMAN
Administrator

FmHA Farmers Home Administration is an Equal Opportunity Lender
Complaints of discrimination should be sent to
Secretary of Agriculture, Washington, D C 20250

UNITED STATES DEPARTMENT OF EDUCATION

WASHINGTON, D.C. 20202

AUG 7 1991

Mr. Tom Stack
Chief, Credit and Cash
Management Staff
Office of Management and Budget
Room 10227
New Executive Office Building
Washington, D.C. 20503

Dear Mr. Stack:

This is in response to your letter of July 3, 1991, requesting comments on the report of the Federal Credit Policy Working Group, Sub-Group on Credit Extension. To the extent that they can be applied to the Department of Education (ED), we agree with the Sub-Group's recommendations. ED especially endorses the Sub-Group's conclusion that oversight must be strengthened and that this can be most effectively done by shifting emphasis from better management of individual loans to better management of lenders.

Below is a discussion of our observations and comments on the general report and the various committee reports. As is discussed in the Sub-group's report, ED's relationship with lenders is primarily through guaranty agencies, who act as intermediaries between ED and lenders. Our comments should be considered in this context.

Common Data Base. ED supports the recommendation to establish a common data base, especially one that would report data permitting an evaluation of financial stability and the sharing of this information among the Federal agencies. ED believes that conclusions regarding financial stability must be derived from data which include an assessment by Federal agency experts of the lender's overall exposure to risk.

Standard Lender Agreements. ED endorses the model agreement concept and the provision that each Federal agency have the ability to add program specific items to its agreements. Subject to the limitation of operating through a guaranty agency, ED is seeking legislative authority to standardize lender agreements.

Recertification of Lenders. ED agrees with the Sub-Group's observation that continued program participation should not be regarded as a right, but should be subject to recertification and sanction. ED believes, however, that it has mechanisms in place to address problems that might result from an absence of procedures to test lender performance, or that might result from a lack of authority to require lender improvement or which would permit termination of eligibility to participate in loan programs.

Credit Extension Sub-Group -- Page 2

Lenders, including National or State charted banks, S&L associations, credit unions, pension funds, and insurance companies among others, are eligible to participate in ED loan programs by legislation. Lenders become eligible for guarantees and interest subsidies after meeting the legal definition and entering into a lender agreement with a guaranty agency. ED's role in determining lender eligibility to participate in the loan programs is exercised through its relationship with the guaranty agencies.

Once a lender becomes eligible to participate in the loan programs, ED and the guaranty agencies review principal participants in the program on an on-going basis. Based on these reviews, both ED and the guaranty agency can take limitation, suspension, and termination actions to restrict or end a lender's eligibility to participate in student loan programs. Although not referred to as a recertification process, post-participation reviews serve the same function.

ED is currently reviewing policies and procedures in order to improve lender oversight. Included among these are the effort to achieve a standard lender agreement, improvements in review content and selection, and development of methodologies to review lender financial stability. Improvements in these areas will accomplish the goals of a certification/recertification process, but in a format appropriate to ED's authority and operations.

Categorization of Lenders and Servicers. ED endorses the categorization of lenders and the distinction between lenders and servicers. ED believes that lenders merit increased attention and should be covered by appropriate legislation and regulation.

Risk Sharing. The Department of Education has imposed risk sharing on the guaranty agencies. ED strongly supports the concept of "risk sharing" and has proposed legislation to reduce a lender's interest subsidy if default rates reach certain levels. ED believes that risk sharing is most appropriate as a remedy to an identified problem, such as an extraordinarily high default rate.

ED agrees with the Sub-Group that the approach to risk sharing should be circumspect, especially in the case of ED's programs, since it is a matter of public policy to make loans to a high risk group. The effects of risk sharing on the large secondary markets must be considered. As ED's recent experience indicated, the perceived risk imposed on Sallie Mae, when the Higher Education Assistance Foundation became insolvent affected financial market stability. In addition, there is a risk of a loss of accessibility to loans, if the lender's risk crosses a certain threshold.

Stronger Sanction Authority. ED endorses seeking authority for stronger sanctions against guarantors and lenders, including the prompt withdrawal of participation rights. ED's present authority to impose monetary penalties is very limited by legislation and authority to impose other sanctions requires a hearing.

As part of its Higher Education Act Reauthorization package, ED has proposed statutory changes to remove current limitations on our fine authority..

Bankruptcy Laws. ED is concerned about the effect of bankruptcy laws that preclude adverse actions against a financially troubled lender. ED recommends that the matter be studied and that effective strategies and options for dealing with problems, including inter-agency co-operation, as well as specific problem targeted legislation, be developed. However, ED does not see the practical value of seeking legislation "to clarify" the matter, if the aim of clarification would be to deny a lender the means to make loans. This is contrary to the principles of bankruptcy protection.

Review Guides. ED endorses the development and use of review guides developed to accomplish the recommendation of the Sub-Group that is oriented toward lender management as opposed to loan management. The review guides should be tailored for categories of lenders and/or servicers, and tailored for the form of review (data or on-site).

Two Forms of Reviews. Whether or not the central data base is developed, ED endorses the concept of two forms of reviews, namely: data reviews; and, on-site process, loan file and documentation reviews. The data reviews would occur frequently and could be used to identify the need for specific on-site reviews.

Credit Screening Models. ED has proposed legislation to require lenders to obtain credit reports for individuals 21 years of age and older and to require a co-signer when such a student has a negative report. However, the Higher Education Act expressly prohibits most forms of credit screening. Considering this along with the public policy objective of assisting needy students, ED does not view credit screening models as generally applicable to its guaranteed loan operations.

Lender Watch List. For the reasons stated by the Sub-Group, ED is not in favor of developing a lender watch list. ED also believes that the purpose of the list could be accomplished through an effective central data base with appropriate flags that identify problem lenders.

Co-ordinated Lender Reviews. ED does not believe that single co-

Credit Extension Sub-Group -- Page 4

ordinated lender reviews would be an effective review mechanism for ED. ED is interested in the final assessment of a lender or servicer's operations as determined by other Federal agencies, but ED's programs share little in common with those of the other Federal agencies. ED believes that the emphasis on the management of lenders will still need be done in the context of the administration of the particular Federal agency programs.

Lender Review Board. ED agrees that giving Federal agency heads sufficient authority to impose sanctions would make a Lender Review Board unnecessary.

OMB Bulletin 91-05. ED agrees with the Sub-Group's specific comments concerning OMB Bulletin 91-05, while noting that the following details, which are not completely covered above, have limited application to ED's programs:

- applicant screening principles do not generally apply to ED's entitlement programs.
- credit risk analysis of borrowers does not generally apply to ED in the area covered by the Bulletin.
- collateral requirements do not apply to ED's guaranteed loan programs.
- ED's lender reviews are compliance reviews that can result in a loss of eligibility to participate in loan programs. They are not recertification reviews. ED does not have a formal certification/recertification procedure.
- OCC loan classification principles are not easily applied to ED's loans, especially in the early lending and collection stage. Some classification distinctions can be made on the basis of the type of school attended and, perhaps, other factors..

We appreciate the opportunity to comment on this important report. If you have any questions concerning our comments, please give me a call on 401-0207.

Sincerely,

Mitch

Mitchell L. Laine
Deputy Chief Financial Officer and
Director, Accounting and Financial
Management Services

U. S. Department of Housing and Urban Development
Washington D C 20410-8000

OFFICE OF THE ASSISTANT SECRETARY FOR HOUSING-FEDERAL HOUSING COMMISSIONER

JUL 29 1991

Mr. Thomas P. Stack
Chief
Credit and Cash Management Branch
Office of Management and Budget
725 17th Street, NW
Washington, DC 20503

Dear Mr. Stack:

We have reviewed the Sub-Group on Credit Extension Report and have the following comments:

- Improved planning and coordination of single family property management and disposition does not require a consolidated management and disposition organization for federal single family housing properties. We must maintain the flexibility to address individual agency property disposition needs and the study should consider all alternatives to achieve improved coordination.

- The concept of a common data collection facility to handle all data requirements for lender monitoring is very ambitious. The suggestion that the quality of the data submission will be enhanced is questionable. There is no basis to assume that if a lender is reporting to one source, the quality of the data submission will improve. In addition, it seems that regulatory agencies would still require data submission to meet oversight responsibility.

- The need for a Department of Justice review for an agency to deny lender certification is unclear. The lender agreement should include the standards by which a lender will be recertified. Failure to meet these standards should be the basis for not recertifying.

- The recommendation to abolish the "high level review board" is not needed. Each agency should be permitted to address this concern in a manner which is acceptable to it. The issue is not whether to establish a "board" but for the agency to take aggressive action when appropriate in lender monitoring.

2

Implementation of several of these recommendations could require significant amounts of staff time and other resources for each agency. In view of current budget constraints, we recommend that these costs be identified early, and funding resources identified before commitments are made to implement the recommendations.

Very sincerely yours,

Eleanor M. Clark
Housing-Federal Housing
Administration Comptroller

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

August 6, 1991

MEMORANDUM TO: Frank Hodsoll
Executive Associate Director
Office of Management and Budget

FROM: Gerald Murphy
Fiscal Assistant Secretary

SUBJECT: Report of the FCPWG Subgroup on Credit Extension

FMS has already commented on the subject report, but I would like to offer some additional views.

(1) Regarding the conclusion that emphasis of agencies should be shifted to better management of lenders, I believe that the assumption that the current emphasis is on management of individual loans may be a bit misleading. Other options are possible, e.g., an emphasis on building as many incentives into the process as possible to insure that reasonable judgement is used and reasonably conscientious servicing is performed at each step of the process.

(2) Re: the conclusion that financial risk should be consistent with optimum program delivery, this raises the question of whether it is financially responsible to hide what is essentially a grant under the blanket of "defaulted debt." Loans granted with deferred payback and lower interest rates have a clearly identifiable and measurable "grant" aspect to them. If the Government is going to make a de facto grant, it would better reflect the nature of the transaction to call it a grant, not a defaulted loan.

(3) Under the heading of "Risk Sharing," the report suggests that asking a lender to assume 20% of the risk may thwart the delivery of programs to the public, poorly serve the "clientele," and cause participation by the originators to significantly decline. The reduction from 100% guarantees to 80% is an initiative which, to my knowledge, has caused better loan servicing by the financial institution, with no significant change in participation. It would be difficult to explain to the man on the street that the Government should guarantee a loan when the originator is not willing to underwrite at the 20% level.

(4) The section on "Underwriting Standards" states that the subgroup was concerned about the importance placed on credit scoring models, that no evidence was found that any private sector company relied solely on credit scoring as an

- 2 -

underwriting method, and that credit screening should be done at the discretion of each agency. Again, this is not an either/or situation with agency discretion at one end and a rigid scoring system at the other.

(5) The emphasis on lender reviews may be desirable, but may be somewhat unrealistic in view of budget constraints. No system created should be dependent on them.

(6) Page 12 of the Report states that provisions need to be made to allow agencies to remove bad lenders more quickly, that action is needed to ease debarment procedures, and that Treasury should create and sponsor this initiative Government-wide. In addition to the legal liability this would create, I dont see this as an appropriate role for the Department of the Treasury.

I hope that these comments will be of some assistance.

DEPARTMENT OF THE TREASURY
FINANCIAL MANAGEMENT SERVICE
WASHINGTON, D.C. 20227

COMMISSIONER

July 17, 1991

Dear Frank:

We have reviewed the report developed by the Federal Credit Policy Sub-Group on Credit Extension, chaired by Jonathan Kislak. The report proposes a radical shift in the way the Government manages its guaranteed loans with its focus on managing lenders, not loans. We agree with the report that lender management is the key to improving the Government's guaranteed loan operations. This reaffirms the emphasis and position previously taken the Federal Credit Policy Working Group in its approval of the recommendations contained in the Guaranteed Loan Management Assessment, conducted by the Financial Management Service in 1990.

We offer the following comments:

1. We support the concept of a common lender monitoring database in order to ease the potential reporting burden on lenders. We believe, however, that the agencies, not the service bureau, must take ownership of the information maintained in such a database. If the agencies have no responsibility for the accuracy of the data or if the accuracy is ever called into question, it would be easy enough for the agencies to deny its value for lender and loan portfolio monitoring and refuse to use it for the very purpose for which it was created.

2. We continue to believe that it is possible to establish standard lender agreements, which provide the necessary flexibility for each agency while still establishing specific core requirements for lenders. We are willing to work with the agencies to develop such agreements.

3. We strongly support the report's position on certification and recertification of lenders and agree that participation in a Government guaranteed loan program is not a "right." We do not agree, however, with the report's position against the establishment of a governmentwide lender watchlist. The purpose of the watchlist is to ensure that agencies share information on their lenders' performance with each other, since it is likely that a lender which is performing poorly for one agency is very probably performing poorly for another. We strongly believe that this information needs to be shared, perhaps using one agency such as the Department of Housing and Urban Development, to cross-service for all agencies.

Page 2 -- Mr. Frank Hodsoll

We also do not agree that each agency needs to develop its own checklist for conducting lender reviews. We believe that these checklists should have enough common elements that, at a minimum, loan-type checklists can be developed and used.

4. We agree that a feasibility study for consolidating the management and disposition of single family housing properties should be conducted and plan to incorporate this into our current real property contracting activities.

5. We believe that a risk sharing level of at least 80% Government/20% lender, as stated in OMB Circular A-70, should remain a stated goal. We agree, however, that a lender "profitability" study to determine the profits and risks for lenders participating in the Government's guaranteed loan programs needs to be conducted prior to implementing wholesale risk sharing changes. Such a study would look at the potential impact of making changes in guaranteed loan operations, such as increased risk sharing and reporting requirements, on lender participation. We propose undertaking such a study in FY 1992.

We believe that the report provides valuable and credible recommendations for managing the Government's guaranteed loan operations, which, if implemented, could greatly improve governmentwide financial management.

If you have any questions on our comments, please have your staff contact Victoria I. McDowell, Director of the Credit Administration Division on (202) 287-0665.

Sincerely,

Ernie

W. E. Douglas

Mr. Frank Hodsoll
Chairman, Federal Credit Policy Working Group
Office of Management and Budget
Old Executive Office Building
Washington, DC 20503

DEPARTMENT OF VETERANS AFFAIRS
ASSISTANT SECRETARY FOR FINANCE AND PLANNING
WASHINGTON DC 20420

JUL 17 1991

Mr. Thomas Stack
Chief, Credit and Cash Management Branch
Office of Management and Budget
Washington, DC 20503

Dear Mr. Stack:

By letter dated July 3, 1991, you requested comments about the Sub-Group on Credit Extension Report prior to its printing and distribution in final form. The report recommends changing the concept of monitoring and controlling guaranteed housing programs by concentrating on lenders rather than individual loans. Several recommendations to accomplish this objective are offered. Since these are operational issues, I defer comments to Mr. Keith Pedigo, my VA colleague on the Federal Credit Policy Working Group and Director of VA's Loan Guaranty Service. I do, however, offer the following general comment about the report's proposed governmentwide data base to handle all data requirements for lender monitoring.

One principal recommendation is to "Create a common data collection facility to handle all data requirements for lender monitoring." This would result in establishing a common set of reporting data elements for all lenders nationwide, regardless of types of guaranteed loans handled and for which agency, and report them to one government organization. Individual agencies would then retrieve their pertinent data from this central data base. This centralized reporting is designed to replace the reporting done by lenders to each separate agency for loans handled for that agency. Our current and envisioned data needs must differ in certain aspects from those of other agencies because our housing programs and legislative mandates are different. I support the concept of a central data base but, unless the data elements are extremely comprehensive, I also believe that lenders will still have to report some data directly to individual agencies. A more extended discussion of the intent and composition of the common data base should be included in the final report, particularly addressing what types of data will no longer be reported to individual agencies; what data, if any, will continue to be individually reported; and what data not now collected (by the VA) may be required of lenders.

Sincerely yours,

Frank D. Derville

Frank D. Derville
Deputy Assistant Secretary
for Financial Management